



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Draft

Date Amended:	03/28/07	Bill No:	<a href="#">SB 1024</a>
Tax:	Emergency Telephone Users Surcharge	Author:	Kehoe
Related Bills:			

## BILL SUMMARY

Among other things, this bill would do the following:

- Revise the definition of “service supplier” to mean any person supplying intrastate telephone communication services capable of originating a “911” emergency telephone call from any service user in the state.
- Make several clarifying changes to the definitions contained in the Emergency Telephone Users Surcharge Act (Act).<sup>1</sup>

## ANALYSIS

### CURRENT LAW

#### Emergency Telephone Users (911) Surcharge Act

Under existing law, Section 41020 of the Revenue and Taxation Code imposes a surcharge on amounts paid by every person in the state for intrastate telephone communication services. The current surcharge rate is 0.50 percent of the amounts paid for intrastate telephone services in this state. The surcharge is paid to the Board and deposited in the State Treasury to the credit of the State Emergency Telephone Number Account in the General Fund. The funds in this account are used to pay for the costs of administration of the 911 emergency telephone number system.

Section 41010 defines intrastate telephone communication services to mean all local or toll telephone services where the point or points of origin and the point or points of destination of the service are all located in this state.

Section 41015 defines “local telephone service” to mean both of the following:

- (a) The access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radiotelephone stations constituting a part of the local telephone system.
- (b) Any facility or service provided in connection with a service described in subdivision (a).

The term “local telephone service” does not include any service which is a “toll telephone service” or a “private communication service.”

Section 41016 defines “toll telephone service” to mean:

- (a) A telephonic quality communication for which (1) there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication and (2) the charge is paid within the United States, and

<sup>1</sup> Part 20 (commencing with Section 41001) of Division 2 of the Revenue and Taxation Code.

(b) A service which entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radiotelephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.

Section 41021 requires every service supplier to collect the surcharge from each service user at the time it collects its billing from the service user. A service provider is defined in Section 41007 to mean any person supplying intrastate telephone communication services pursuant to California intrastate tariffs to any service user in this state. The term also includes any person supplying intrastate telephone communications services for whom the California Public Utilities Commission (CPUC), by rule or order, modifies or eliminates the requirement for that person to prepare and file California intrastate tariffs.

Section 41020 provides, in accordance with the federal Mobile Telecommunications Sourcing Act (P.L. 106-252), that the surcharge does not apply to any charges for mobile telecommunications services billed to a customer where those services are provided, or deemed provided, to a customer whose place of primary use is outside this state.

"Charges for mobile telecommunications services" is defined to mean any charge for, or associated with, the provision of commercial mobile radio service, as defined in Section 20.3 of Title 47 of the Code of Federal Regulations, as in effect on June 1, 1999, or any charge for, or associated with, a service provided as an adjunct to a commercial mobile radio service, that is billed to the customer by or for the customer's home service provider, regardless of whether individual transmissions originate or terminate within the licensed service area of the home service provider.

"Mobile telecommunications service" is defined to mean commercial mobile radio service, as defined in Section 20.3 of Title 47 of the Code of Federal Regulations, as in effect on June 1, 1999.

### **Federal Law**

Under existing federal law, an excise tax is imposed on amounts paid for communications services. The term "communication services" is defined to mean, in part, local telephone service and toll telephone service. "Toll telephone service" is defined in Section 4252(b) of Title 26 of the United States Code to mean:

1. A telephonic quality communication for which (A) there is a toll charge which varies in amount with the distance **and** elapsed transmission time of each individual communication and (B) the charge is paid within the United States, and
2. A service which entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radio telephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.

The federal excise tax on telephone services is administered and collected by the Internal Revenue Service (IRS).

**PROPOSED LAW**

Among other things, this bill would make various changes to definitions contained in the Act. These definitional changes include:

- Section 41007: The definition of “service supplier” would be amended to mean any person supplying intrastate telephone communication services *capable of originating a “911” emergency telephone call from any service user in the state.*
- Section 41010: The definition of “intrastate telephone communication services” would be amended to provide that, when bundled services include an intrastate telephone communication service or services, the bundled services are “intrastate telephone communication services.”
- Section 41011: The definition of “charges for services” would be amended to specifically include bundled service charges and to make other technical changes.
- Section 41016: The definition of “toll telephone service” would be amended to clarify that 1) either of the services described in subdivisions (a) and (b) constitutes a “toll telephone service,” and 2) toll charges vary in amount by distance or elapsed transmission time of each individual communication. These amendments to Section 41016 would not constitute a change in, but would be declaratory of, existing law.

This bill would also add Section 41011.5 to the Revenue and Taxation Code to define “bundled service” to mean telecommunications services or telephonic quality voice communication services that are not billed separately, and includes all of the following:

- Service supplied pursuant to a plan that does not separately state the charge for the local telephone service or calling features.
- Service utilizing Interconnected Voice over Internet Protocol (VoIP).
- Service supplied to a service user utilizing a prepaid telephone card or prepaid wireless service.
- Service provided to a service user pursuant to a plan that provides both local and toll telephone services and, if included, calling features for either a flat monthly fee or a charge that varies with the elapsed transmission time for which the services are used.
- Service under a plan for local exchange services and mobile telecommunications services.

"Calling features" would be defined to include, but not limited to, three-way calling, call forwarding, caller identification functions, including identification blocking, call waiting, and centralized telephone messaging, including voicemail.

Furthermore, this bill would amend provisions of Section 41020 relating to conforming the Act to the federal Mobile Telecommunications Sourcing Act. Specifically, the definitions of “charges for mobile telecommunications services” and “mobile telecommunications service” would no longer reference “commercial mobile radio service, as defined in Section 20.3 of Title 47 of the Code of Federal Regulations.” Instead, the definitions would refer to “mobile telephony service, as defined in Section 224.4 of the Public Utilities Code.” In addition, Section 41020 would provide that the surcharge does not apply to any charges for “telephonic quality voice communication services” if they are billed to a customer where those services are provided, or deemed provided, to a customer whose place of primary use is outside this state.

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And lastly, this bill would add Section 41152 to the Revenue and Taxation Code to incorporate the Legislature's findings and declarations, which are as follows:

- Access to emergency telephone service has been a longstanding goal of the state.
- The Act remains an important means for making emergency telephone service available to every person in this state.
- Every reasonable means should be employed by telephone corporations and every provider of telephonic quality communication to ensure that every person using their service is informed of, and is afforded the opportunity to use, emergency telephone service, regardless of the means by which emergency telephone calls are placed.
- The furnishing of emergency telephone service is in the public interest and should be supported fairly and equitably by every telephone corporation and every provider of telephonic quality communication in a way that is equitable, nondiscriminatory, and competitively neutral.

The bill would become effective immediately as an urgency statute.

#### IN GENERAL

According to the Department of General Services (DGS) staff, there are 500 official public safety answering points (PSAPs) that are funded by the 911 surcharge. PSAPs include primarily law enforcement agencies, such as local police and sheriff departments, and fire departments. The 911 surcharge revenues pay for all of the network and infrastructure that support 911 services, and ongoing support for refreshing equipment, the network, and database information that appears at each site when someone calls "911." The annual budget is approximately \$108 million, plus \$49 million this year to deploy wireless enhanced 911 service. As of July 1, 2006, the State Emergency Telephone Number Account had a \$132 million reserve. Effective November 1, 2006, the rate was reduced from 0.65 percent to 0.50 percent, which is the lowest rate allowed in the statute, and cannot be increased until November 1, 2007. Revenues had been running at approximately \$130 million per year. The reduced rate is expected to produce only \$112 million for the 2006/07 fiscal year.

**Toll telephone service.** With the advent of telephone services where the charges vary based only on the elapsed time, and not on the distance between the caller and the recipient of the call, questions arose as to whether such services constituted "toll" services under the federal definition. A number of cases were brought to challenge the imposition of the federal excise tax on these services. Five federal appellate courts agreed with the claimants that the tax could not be imposed on the charges for these services because, since the charges for the services did not vary with the distance of the call, the services did not come within the federal definition of toll telephone services, nor did they constitute local telephone services. (*American Bankers Insurance Group v. United States* (11th Cir. 2005) 408 F.3d 1328; *OfficeMax, Inc. v. United States* (6th Cir. 2005) 428 F.3d 583; *National Railroad Passenger Corp. v. United States* (D.C.Cir. 2005) 431 F.3d 374; *Fortis, Inc. v. United States* (2d Cir. 2006) 447 F.3d 190; and *Reese Brothers, Inc. v. United States* (3d Cir. 2006) 447 F.3d 229.)

The courts held that, with respect to the definition of "toll telephone service" as provided in Section 4252(b)(1)(A) of the United States Code, the word "and" (emphasized above) is used "conjunctively" and could not be construed to be used "disjunctively" to mean

“or.” Neither the Ninth Circuit nor the U.S. Supreme Court has issued an opinion on this legal issue.

On May 25, 2006, the IRS announced that it would stop collecting the federal excise tax imposed on long-distance telephone service. In addition, the IRS published IRS Notice 2006-50 (see [http://www.irs.gov/irb/2006-25\\_IRB/ar09.html](http://www.irs.gov/irb/2006-25_IRB/ar09.html)), which provided the background and basis for its decision and the rules for obtaining refunds of federal excise tax paid during the period March 1, 2003, through July 31, 2006.

### BACKGROUND

In 2001, Assembly Bill 1458 (Kelley) would have revised the Emergency Telephone Users Surcharge Law to instead impose a surcharge upon service users for each access line for each month a service user subscribes or contracts with the service supplier. This Board-sponsored measure was intended to simplify the application of the surcharge for service suppliers by eliminating the complicated calculations and interpretations of what charges are subject to the 911 surcharge. That bill was amended to remove these provisions before the bill was heard in its first policy committee.

### COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the DGS and is intended to:
  - Change the definition of “toll charges “ to include time or distance instead of time and distance, in response to an IRS ruling which announced that, under the current federal definition, toll charges are not subject to the federal excise tax, and
  - Add language that allows for the collection of the 911 surcharge from all telephonic quality voice communication services capable of originating a “911” emergency call from any service user in this state, regardless of how the communication is transmitted.
2. **Does this bill expand the service supplier base?** This measure would expand the current definition of service supplier. Currently, the definition limits the persons required to collect the surcharge from service users by providing that such persons must 1) supply intrastate telephone communication services, and 2) be regulated by the CPUC. The proposed definition of service supplier would remove the requirement that such persons be regulated by the CPUC and replace it with the criterion that the services provided be capable of originating a “911” emergency telephone call. Therefore, the proposed definition would encompass suppliers of intrastate telephone communication services that have never been regulated by the CPUC, such as VoIP service providers, if they provide a “telephone” service capable of originating a “911” emergency telephone call. VoIP is a service which allows you to make phone calls through the Internet.
3. **Application of the surcharge to bundled services.** Billing practices vary among individual service providers. Under existing law, the surcharge applies to all services (e.g. calling features such as call waiting or caller ID) included in a bill containing intrastate telephone services that are subject to the 911 surcharge. This is the case whether the services are provided for a bundled or unbundled price.

The surcharge also applies to a charge that includes interstate, long distance services (where the point of origin is located in this state and the point of destination

of the service is located outside this state) bundled with intrastate telephone services that are subject to the 911 surcharge. However, the interstate, long distance services are not subject to the surcharge if the service supplier can clearly show the breakdown of charges.

The proposed definition for “bundled service,” and the inclusion of that term within the definitions of “intrastate telephone communication services” and “charges for services,” does not change, but clarifies, existing law.

4. **How does the surcharge apply to cellular telephone services and prepaid telephone cards?** The application of the surcharge to cellular telephone services is no different than the application of the surcharge to landline services.

With respect to prepaid telephone calling cards, the surcharge applies to the dollar amounts deducted or the value of the minutes deducted from the prepaid telephone calling card by the providing service supplier to the extent that those dollar amounts or minutes were deducted to pay for intrastate telephone communication services provided to the user of the card. Dollar amounts or minutes deducted for interstate telephone communication services are exempt from the surcharge, and the dollar amounts or minutes of telephone service that are forfeited because they were not used prior to the expiration of the prepaid telephone calling card are not subject to the surcharge.

5. **Has the state’s definition of “toll telephone service” been challenged?** As of the date of this analysis, neither the Federal Ninth Circuit Court of Appeals nor any California state court of appeals has addressed the subject of the state’s definition of “toll telephone service.” It is reasonable to expect that a California state court will be asked to consider the definition, and it is possible that the court could decide that the 911 surcharge may not be imposed on charges for toll telephone service that do not vary by both elapsed time and distance, as “toll telephone service” is presently defined.

The Board has received two claims for refund, one dated September 25, 2006, and one dated January 19, 2007, asserting that the “and” in question should be construed conjunctively (citing the recent federal developments). These claims are being denied on the basis that Board staff currently administers and has consistently interpreted the “and” to have a disjunctive meaning (i.e., to mean “or”) and has administered every aspect of the 911 surcharge program in a manner consistent with this interpretation since the inception of the program.

6. **Suggested amendment.** The revisions to the definition of “charges for services,” as proposed in Section 41011(a), strike language that is necessary to distinguish between types of services. The language, as revised, is repetitive, and the apparent original intent of simply providing clarification is removed. This subdivision should be amended to reflect existing law, except that it should include the reference to “intrastate *wide* area telephone service charges” and a clarification that “charges for services” includes bundled service charges.

Board staff understands that this measure is a work in process and that the DGS is continuing to work with all interested parties, including Board staff, in developing and further refining the language in the bill.

**COST ESTIMATE**

The Board would incur additional costs in administering the proposed changes because this bill would result in an increase in the number of service suppliers that are required to report and pay the 911 surcharge. The start-up costs would include identifying and registering additional surcharge payers, revising Board publications, and training Board staff. On-going costs would include the mailing and processing of additional returns and surcharge payments and increases in compliance and audit efforts, due to the increase in the number of surcharge payers. A detailed cost estimate is pending.

**REVENUE ESTIMATE**

This measure would not affect the state's revenues. The 911 surcharge is set at a rate necessary to fully fund the 911 program.

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